To: California Market Advisory Committee on Climate Change
From: Laurence B. DeWitt, Pace University Energy Project
Re: Who gets CO2 allowances and on whom should we place the cap?

Designing a cap and trade program for controlling CO2 involves three threshold issues: setting the cap level correctly, placing responsibility for meeting the cap with the proper entity, and distributing allowances efficiently and to the right parties. The rest of the design of the program consists of more detailed, if extraordinarily difficult, issues, such as administering offsets and other flexibility mechanisms.

I would like to speak to the point of regulation and allowance issues. The consumer-environmental position in RGGI has always been that all of the allowances should be given to their rightful owners—the consumers. The allowances constitute the "right to pollute" and only the consumers or the public own that right. At the beginning of the RGGI process, consumer and environmental representatives strongly preferred that allowances and cap responsibility be assigned to load so that the cost of the program to consumers, and the parallel windfall to generators, would be minimized. Generators would still bid their electricity into the wholesale market, but load serving entities (LSE) would have an added carbon charge which they could, in part or in whole, pay for through the allowances they are given. It becomes the LSE's responsibility to make portfolio management decisions about the optimal mix of clean energy, fossil energy, energy efficiency and load management for their customers.

In the RGGI context, the RGGI State Working Group ruled-out an "allocation to load" approach near the beginning of the process and it was not subsequently raised seriously. However, leakage is an issue in RGGI as it is in California, and "allocation to load", seems to be an inherent part of all reasonable "fixes" for leakage: requiring LSEs to submit allowances to cover the CO2 emissions of electricity imported from outside of RGGI. To address leakage, it is possible to design allocation-to-load "add-ons" to our RGGI auction-and-allocation-to-consumers-with-some grandfathering-to-generators-maybe system. It would be cleaner to have a straight allocation-to-load system. As an advocate and expert who has been intimately involved in the design of the RGGI cap-and-trade program, I encourage you and others in California to continue to develop the program details needed to make a load-side approach, as developed in Oregon and proposed by the California PUC, a reality.

To be clear, the RGGI approach does address the most important consideration: do not give allowances to generators for free since they will charge consumers for them anyway and gain a huge windfall in the process. Auctioning allowances also collects a large fund of proceeds that can be either returned to consumers through distribution company "rebates", or, far better, invested in energy efficiency measures to reduce future consumer costs and costs of CO2 compliance.

Nevertheless, I believe that a straight allocation to load is the mechanism that will achieve a given cap-and-trade goal at the least cost to consumers. In a generator-side cap, whether generators are given allowances, or buy allowances in a competitive wholesale market, they raise the wholesale price by the market value of their allowance requirement. All of the non-emitters benefit by receiving this "carbon bump"—at direct consumer expense (although the coal generators lose a little margin). In contrast, by giving the allowances and a carbon budget to load in the first place, the premium paid by

consumers comes purely from the net cost of replacing some dirtier cheaper generators with some relatively cleaner ones.

Finally, one of the main strengths of a system which puts the responsibility for compliance on consumers is that it avoids the otherwise inevitable debate about if, when and how many of the allowances the generators will receive! This is an important issue for consideration at the national level. The nation will learn a lot from efforts in California and Oregon to develop load-side caps for the power sector, and I hope that work continues.